

**CALIFORNIA INSTITUTE FOR
REGENERATIVE MEDICINE**
(A Special Revenue Fund of the State of California)

**FINANCIAL STATEMENTS WITH
INDEPENDENT AUDITOR'S REPORT**

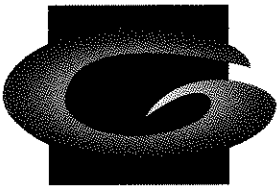
**FOR THE PERIOD FROM INCEPTION
(NOVEMBER 2, 2004) TO JUNE 30, 2005**

**CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE
(A Special Revenue Fund of the State of California)**

JUNE 30, 2005

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Gilbert Associates, Inc.
CPAs and Advisors

INDEPENDENT AUDITOR'S REPORT

**To the Members of the
Independent Citizen's Oversight Committee
Sacramento, California**

We have audited the accompanying financial statements of the California Institute for Regenerative Medicine (CIRM), a special revenue fund of the State of California, as of and for the period from inception (November 2, 2004) to June 30, 2005, as listed in the table of contents. These financial statements are the responsibility of CIRM's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 2, the financial statements of CIRM are intended to present the financial position and the changes in financial position of only that portion of the activities of the State of California that are attributable to the transactions of CIRM. They do not purport to, and do not, present fairly the financial position of the State of California as of June 30, 2005, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CIRM as of June 30, 2005, and the results of its operations for the period from inception (November 2, 2004) to June 30, 2005 in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 through 6 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the basic financial statements of the CIRM. The accompanying supplementary information – combining schedule of net assets and combining schedule of activity are presented for the purpose of additional analysis and are not a required part of the basic financial statements. The combining schedule of net assets and combining schedule of activity have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Gilbert Associates, Inc.

GILBERT ASSOCIATES, INC.
March 10, 2006

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**CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE
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MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE PERIOD FROM INCEPTION (NOVEMBER 2, 2004) TO JUNE 30, 2005

Introduction

The following Management's Discussion and Analysis (MD&A) provides an overview to the financial statements of the California Institute of Regenerative Medicine (CIRM), a description of its activities and an analysis of the financial position of CIRM.

The audited financial report for CIRM is required under Health and Safety Code Section 125290.30(b). This audit covers the financial activities of CIRM for the state fiscal year ended June 30, 2005.

California Institute of Regenerative Medicine and Current Programs

CIRM is an agency of the State of California established under the provisions of Proposition 71 - the California Stem Cell Research and Cures Act. CIRM's responsibilities are:

- To make grants and loans for stem cell research, for research facilities and for other vital research opportunities to realize therapies, protocols, and/or medical procedures that will result in, as speedily as possible, the diagnosis, treatment and cure for, and/or substantial mitigation of, major diseases, injuries and orphan diseases.
- To support all stages of the process of developing treatments and cures, from basic research and discovery through preclinical and translational research to the conduct of successful clinical trials.
- To establish the appropriate regulatory standards and oversight bodies for research and facilities development.

Proposition 71 authorizes the State to issue, under the oversight of the Office of State Treasurer, \$3 billion in state issued tax-exempt and taxable bonds to fund CIRM's operations, medical and scientific research, including therapy development through clinical trials and facilities. CIRM is authorized to receive a \$3 million loan from the General Fund (Health and Safety Code Section 12290.70(b)) and to issue Bond Anticipation Notes (BANS) to fund CIRM's initial grants and operational costs until the bonds can be issued. Both will be repaid with interest from the proceeds of bonds when they are issued.

In addition, Proposition 71 established the Independent Citizens' Oversight Committee (ICOC), to govern CIRM. The ICOC may accept additional revenue and real and personal property, including, but not limited to, gifts, royalties, interest, and appropriations that may be used to supplement annual research grant funding and the CIRM operations.

During the current fiscal year litigation has delayed the issuance of bonds (see Note 9 to the Financial Statements). As a result, the funding available to CIRM has been limited to the \$3 million general fund loan and a \$5 million grant from the Dolby Family Foundation.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE PERIOD FROM INCEPTION (NOVEMBER 2, 2004) TO JUNE 30, 2005

Financial Highlights

Condensed financial information as of and for the period ended June 30, 2005 is presented below:

Capital Assets	\$	0
Other Assets		<u>5,112,154</u>
Total Assets		<u>5,112,154</u>
Long-term Liabilities	\$	0
Other Liabilities		<u>2,654,541</u>
Total Liabilities		<u>2,654,541</u>
Restricted Net Assets	\$	<u>2,457,613</u>
Total Net Assets		<u>2,457,613</u>
Grant Revenue	\$	5,000,000
Other Revenue		<u>84,660</u>
Total Revenue		<u>5,084,660</u>
Salaries and Benefits	\$	736,705
Operating Expenses		<u>1,890,342</u>
Total Expenses		<u>2,627,047</u>
Change in Net Assets	\$	<u>2,457,613</u>

- Comparative analysis will be provided in future years when prior year information is available.
- CIRM relied primarily on the General Fund loan for its operations which totaled \$2,627,047 as follows:

Salaries and Benefits	\$	736,705
Operating Expenses		1,890,342

See Note 5 to the Financial Statements for a discussion of the treatment of free rent received by CIRM at its temporary headquarters in Emeryville, California.

- While there was insufficient funding to issue grants, CIRM was able to develop and issue its first Request for Applications to fund a program of training grants. These grants will be used by California public colleges and universities and non-profit academic and research institutions in California to foster training in stem cell research at the level of pre-doctoral students, post-doctoral fellows and clinical fellows.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE PERIOD FROM INCEPTION (NOVEMBER 2, 2004) TO JUNE 30, 2005

- The ICOC held 35 public meetings at which the following major actions were taken:
 - Established a Medical and Scientific Standards Working Group composed of five ICOC patient advocate members, nine nationally recognized scientists and four biomedical ethicists to develop proposed regulations governing CIRM-funded research.
 - Established a Scientific and Medical Research Funding Working Group composed of seven ICOC patient advocate members and 15 nationally prominent stem cell scientists from outside the State of California to develop recommendations for the evaluation criteria and to evaluate specific research proposals related to CIRM's first grant program – the CIRM Training Program in Stem Cell Research.
 - Established a Facilities Working Group composed of five ICOC patient advocate members and four experts in the field of real estate management.
 - Appointed Zach Hall, Ph.D - an eminent neuroscientist and scientific leader and administrator – as Interim President of CIRM. Also, appointed Dr. Arlene Chiu - a distinguished neuroscientist and former Grants Administrator with the National Institute of Health – as the Director of Scientific Programs and Review Activities.
 - Adopted conflict of interest policies for ICOC members, CIRM staff and members of the three working groups mentioned above.

- In addition, the limited staff at CIRM were able to accomplish the following:
 - Secure temporary headquarters space for free in Emeryville, California.
 - In partnership with the California State Department of General Services, conducted a statewide search for a permanent site. On May 5, 2005, the ICOC approved a location at the San Francisco. With free rent, free architectural services, free build-out to suit and other incentives, the value of which to CIRM over 10 years is estimated up to \$18 million.
 - Establish policies and procedures for travel and per diem reimbursement and contract procurements and develop and implement an accounting system that tracks operational expenditures.

Using this Annual Financial Report

The financial statements included in this annual financial report are those of CIRM and do not purport to present the financial position of any other reporting entity.

Overview of the Financial Statements

This MD&A is an introduction to the financial statements and accompanying notes. The financial statements of CIRM are presented as a special revenue fund of the State of California engaged primarily in financing activities - providing stem cell research and research facilities grants and loans to educational and private and non-profit research institutions located in the State of California. The financial statements have been prepared using two kinds of statements that generally present different views of CIRM. The *government-wide financial statements* provide both short-term and long-term information about CIRM's overall financial status using the accrual basis of accounting and the economic resources focus. The *fund financial statements* generally provide a short-term view that helps in the determination of whether there are more or fewer financial resources that

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MANAGEMENT'S DISCUSSION AND ANALYSIS

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can be spent in the near future to finance CIRM's programs. The fund financial statements are prepared using the modified accrual basis of accounting and focus on current financial resources. As of and for the period ending June 30, 2005, the presentation of the government-wide financial statements did not differ substantially from the presentation of the fund financial statements.

The government-wide financial statements report information about CIRM using accounting methods similar to those used by private-sector companies. They include the following two statements:

The *Statement of Net Assets* presents information on the assets and liabilities of CIRM, with the difference between the assets and the liabilities reported as net assets. Over time, increases or decreases in net assets are expected to serve as a useful indicator of whether the financial position of CIRM is improving or deteriorating.

The *Statement of Activities* presents information reflecting how the net assets of CIRM changed during the period ended June 30, 2005. All changes in the net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the cash flows. Thus, revenues and expenses are reported in the statement for some items that will only result in cash flows in future fiscal periods.

The fund financial statements generally focus on (1) how cash and other financial assets that can be readily converted to cash flow in and out and (2) the balances left at year-end that are available for spending. The *Balance Sheet* and *Statement of Revenues, Expenditures, and Changes in Fund Balance* do not encompass the additional long-term focus of the government-wide statements, therefore additional information reconciling the fund financial statements to the government-wide statements is provided in an Adjustments column that explains the relationship (or differences) between them.

The *Notes to the Financial Statements* provide additional information that is essential to a full understanding of the data provided in the financial statements.

Net Assets

The CIRM net assets as of June 30, 2005, were \$2,457,613 all of which were restricted. This represents a combination of \$4,107,903 from the Dolby Grant and \$1,650,290 that is owed to the General Fund. The remainder of the \$3 million General Fund loan - \$1,349,710 – the remainder of the Dolby Grant funding and the proceeds from any BANS that are issued will be used for operational expenses and grant programs in subsequent years until the bonds are issued.

Budgetary Information

All CIRM funds are continuously appropriated without regard to fiscal year to support the CIRM and its grant programs. Continuous appropriation authority means that no further appropriations are necessary to expend funds held in the State Treasury.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE PERIOD FROM INCEPTION (NOVEMBER 2, 2004) TO JUNE 30, 2005

Economic Conditions and Outlook

In general, the State's economy and the fiscal status of its general fund did not have an impact on CIRM funds during the fiscal year. Except for the \$3 million general fund loan authorized by Health and Safety Code Section 125290.70(b), CIRM does not receive any on-going State General Fund support. It is expected that when bonds are issued, the proceeds will provide sufficient revenues to support both CIRM's operational costs and grant programs.

Requests for Information

This financial report is designed to provide interested parties with a general overview of the finances of the CIRM and its funds. Questions concerning the information provided in this report or requests for additional information should be addressed to the following:

Walter Barnes
Chief Administrative Officer
CIRM
210 King Street, Third Floor
San Francisco, CA 94107
(415) 396-9100

CALIFORNIA INSTITUTE OF REGENERATIVE MEDICINE

BALANCE SHEET AND STATEMENT OF NET ASSETS

JUNE 30, 2005

	<u>Stem Cell Fund</u>	<u>Adjustments (Note 3)</u>	<u>Statement of Net Assets</u>
ASSETS			
Cash and equivalents	\$ 5,112,154	\$ -	\$ 5,112,154
Total assets	<u>\$ 5,112,154</u>		<u>\$ 5,112,154</u>
LIABILITIES			
Accounts payable	\$ 1,004,541	-	\$ 1,004,541
Due to other funds	1,650,000	-	1,650,000
Total liabilities	<u>2,654,541</u>	<u>-</u>	<u>2,654,541</u>
FUND BALANCE / NET ASSETS			
Fund balance			
Reserved Fund Balance	2,457,613	(2,457,613)	-
Total liabilities and fund balance	<u>\$ 5,112,154</u>		
Net assets			
Restricted		2,457,613	2,457,613
Total net assets		<u>\$ -</u>	<u>\$ 2,457,613</u>

The accompanying notes are an integral part of these financial statements.

CALIFORNIA INSTITUTE OF REGENERATIVE MEDICINE

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE AND
STATEMENT OF ACTIVITIES**

FOR THE PERIOD FROM INCEPTION (NOVEMBER 2, 2004) TO JUNE 30, 2005

	<u>Stem Cell Fund</u>	<u>Adjustments (Note 3)</u>	<u>Statement of Activities</u>
REVENUES			
Grant Revenue (Note 6)	\$ 5,000,000	\$ -	\$ 5,000,000
Other (Note 5)	84,660	-	84,660
Total revenues	<u>5,084,660</u>	<u>-</u>	<u>5,084,660</u>
EXPENDITURES / EXPENSES			
Salaries and benefits	736,705	-	736,705
Operating expenses	1,890,342	-	1,890,342
Total expenditures / expenses	<u>2,627,047</u>	<u>-</u>	<u>2,627,047</u>
Excess of revenues over expenditures and change in net assets	2,457,613	-	2,457,613
Fund balance / net assets, at inception	<u>0</u>	<u>-</u>	<u>0</u>
Fund balance / net assets, at June 30, 2005	<u>\$ 2,457,613</u>	<u>\$ -</u>	<u>\$ 2,457,613</u>

The accompanying notes are an integral part of these financial statements.

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NOTES TO THE FINANCIAL STATEMENTS

FOR THE PERIOD FROM INCEPTION (NOVEMBER 2, 2004) TO JUNE 30, 2005

1. THE FINANCIAL REPORTING ENTITY

The California Institute for Regenerative Medicine (CIRM) is a state agency accounted for as a special revenue fund of the State of California that was established with the passage of Proposition 71, the California Stem Cell Research and Cures Initiative. The statewide ballot measure, which provided \$3 billion in funding for stem cell research at California universities and research institutions, was approved by California voters on November 2, 2004, and called for the establishment of a new state agency to make grants and provide loans for stem cell research, research facilities and other vital research opportunities.

CIRM was established for the purpose of issuing bonds to support stem cell research for the development of life-savings regenerative medical treatments and cures. CIRM is authorized under Proposition 71 to grant an average of \$295 million per year in bonds over a 10-year period to fund stem cell research and dedicated facilities for scientists at California's universities and other advanced medical research facilities throughout the state.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. BASIS OF ACCOUNTING/FUND FINANCIAL STATEMENTS

Basis of accounting refers to when revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements.

The government-wide financial statement (i.e. the statement of net assets and the statement of activities) reports information on all of the activities of CIRM. The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Separate financial statements are provided for CIRM's operating fund, governmental fund type. This governmental fund's financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, revenues are considered to be available if they are collected within 12 months of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting.

The basic financial statements of CIRM are intended to present the financial position and the changes in financial position of only that portion of the activities of the State of California that are attributable to the transactions of CIRM. They do not purport to, and do not, present fairly the financial position of the State of California as of June 30, 2005, and the changes in its financial position, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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NOTES TO THE FINANCIAL STATEMENTS

FOR THE PERIOD FROM INCEPTION (NOVEMBER 2, 2004) TO JUNE 30, 2005

B. ACCOUNTING PRINCIPLES

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and the accounts are maintained by CIRM in accordance with the principles of fund accounting under standards issued by the Governmental Accounting Standards Board (GASB). Fund accounting is the procedure by which resources for various purposes are classified for accounting and reporting purposes into funds established in accordance with their nature and purpose. The operations of the fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures.

CIRM's operating fund is classified as a non-major special revenue fund of the State of California, referred to as the Stem Cell Research and Cures Fund, and is a governmental fund type.

C. CASH, CASH EQUIVALENTS AND POOLED INVESTMENTS

CIRM considers all short-term investments with an original maturity of three months or less to be cash equivalents. Cash and investments held in the State of California's Surplus Money Investment Fund (SMIF) are considered to be highly liquid and cash equivalents.

D. CAPITAL ASSETS AND DEPRECIATION

Capital assets, when purchased, will be reported in the government-wide financial statements. In accordance with the State's capitalization policy, CIRM's capital assets are defined as assets with a useful life of at least one year and a unit acquisition cost of at least \$5,000. All reported capital assets will be depreciated using the straight-line method. There were no capital assets recorded as of June 30, 2005.

E. TAX EXEMPTION

As a component unit of the state of California, CIRM is exempt from federal and State income taxes.

E. DUE TO OTHER FUNDS

Due to other funds represents amounts payable to the State general fund pursuant to the loan provisions outlined in Proposition 71.

F. CLASSIFICATION OF NET ASSETS AND FUND BALANCE

Restricted net assets and reserved fund balance of CIRM represent amounts restricted due to external restrictions imposed by grantors and restrictions imposed through enabling legislation. All of CIRM's net assets and fund balance are restricted by grantors or statute for programs established by CIRM and for programs administered pursuant to Proposition 71.

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NOTES TO THE FINANCIAL STATEMENTS

FOR THE PERIOD FROM INCEPTION (NOVEMBER 2, 2004) TO JUNE 30, 2005

G. RISK MANAGEMENT

CIRM is a special revenue fund of the State of California, which is primarily self-insured against loss or liability. The State generally does not maintain reserves; losses are covered by appropriations in the year in which the payment occurs or it becomes fixed and determinable. There were no accrued losses at June 30, 2005 that met these criteria.

H. USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the reporting date and revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. RECONCILIATION OF GOVERNMENTAL FUND FINANCIAL STATEMENTS AND GOVERNMENT-WIDE FINANCIAL STATEMENTS

Generally, governmental fund financial statements differ from government wide financial statements due to differences in their measurement focus and basis of accounting. Accordingly, these differences are typically illustrated in reconciling schedules in the financial statements and footnotes. At June 30, 2005, no such differences existed for CIRM.

4. CASH, CASH EQUIVALENTS AND POOLED INVESTMENTS

Cash, cash equivalents and pooled investments at June 30, 2005 were as follows:

Cash in State Treasury	\$ <u>5,112,154</u>
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CIRM has invested excess cash funds in the Surplus Money Investment Fund (SMIF). All of the resources of SMIF are invested through the Pooled Money Investment Account (PMIA). The PMIA investment program is designated by the Pooled Money Investment Board and is administered by the Office of the State Treasurer. Investments in SMIF are stated at fair value. As of June 30, 2005, the CIRM had invested funds in SMIF in the amount of \$5,112,154.

Additional disclosure details required by GASB Statement No. 40, regarding cash deposits and investments risk disclosures can be found in the June 30, 2005 Comprehensive Annual Financial Report of the State of California.

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NOTES TO THE FINANCIAL STATEMENTS

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5. OFFICE LEASE

From February 2005 through June 2005, CIRM's office space in Emeryville, California was provided free of charge. The fair value of the leased space during the period of occupancy was estimated to be \$84,660. Accordingly, revenue and expenditures of \$84,660 have been recorded in CIRM's financial statements.

CIRM continued to occupy office space in Emeryville, California until November 14, 2005, when it took occupancy of new office space in San Francisco, California for use as its headquarters. The San Francisco office space was acquired in response to a competitive bidding process. As part of the City of San Francisco's proposal, approximately 20,000 square feet of premium office space will be provided to CIRM free of charge for the next 10 years. In addition to the office space, a substantial amount of other incentives were included in the proposal. The fair value of the office space and other incentives will be evaluated on an annual basis to ascertain the economic benefit to CIRM.

6. GRANTS AND DONATIONS

Proposition 71 authorized CIRM to receive gifts that may be used for its operations. In June 2005, CIRM received a grant of \$5 million from the Dolby Family Foundation. The grant letter of commitment contained specific expenditure restrictions (including the prohibition to use the funds for payment of loans, including the \$3 million loan from the State General Fund) and allowances. CIRM management believes that CIRM was in compliance with these restrictions as of June 30, 2005.

7. RELATED PARTY TRANSACTIONS

As a Special Revenue Fund within the State of California, other State agencies provided CIRM with various services during the period from inception to June 30, 2005. The State Controller's Office provided administrative and accounting support, the Department of Justice provided legal support, the University of California, San Francisco provided human resources staff, and the Department of Health and Human Services and the Stephen P. Teale Data Center provided information technology support. The total amounts paid (or transferred) and payable to these agencies at June 30, 2005 were as follows:

	<u>Amounts Paid</u>		<u>Amounts Payable</u>
State Controller's Office	\$ -	\$	269,197
Department of Justice	102,767		66,025
University of California, SF	-		40,000
Department of Health & Human Services	272		17,000
Stephen P. Teale Data Center	-		15,000

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FOR THE PERIOD FROM INCEPTION (NOVEMBER 2, 2004) TO JUNE 30, 2005

8. RETIREMENT SAVINGS PLAN

The State of California has established the Alternate Retirement Program (ARP), a retirement program for specified State of California employees hired on or after August 11, 2004. Under the ARP, employees do not earn retirement service credit with California Public Employees' Retirement System of the State of California (CalPERS) during their first two years of employment with the State. Rather, they are automatically enrolled in a retirement savings program, in which an ARP account is automatically set up for each employee as a 401(a) plan—a type of retirement savings account governed by federal IRS rules. During this two-year period, roughly five percent of each employee's paycheck is deducted each month (pre-tax) and deposited in the ARP account. At the end of the two-year period, the employee begins to earn retirement credit as a Tier I member.

Money in the ARP account, plus any interest, remains in that account. The employee will have a 90-day window to exercise a one-time option to (1) buy previous retirement service credit for time in ARP (the State will fund the portion of the liability not paid for the by the employee's APR account); (2) receive a lump-sum distribution; or (3) transfer all funds into a 401(k) account within the Savings Plus Program. Participant's failure to designate an option will result in automatic enrollment in option 3.

Since all CIRM employees as of June 30, 2005 were hired after the implementation of ARP, all CIRM employees participate in this program and are not eligible to participate in CalPERS.

CalPERS issues a separate comprehensive annual financial report that includes financial statements and required supplementary information. Copies of the CalPERS annual financial report may be obtained from the CalPERS Executive Office, 400 P Street, Sacramento, California 95814.

9. CONTINGENCY

CIRM and its officers are currently defendants in three separate legal actions. One of these cases was dismissed in October 2005 and is now pending appeal. Collectively, the two remaining actions seek a declaration that Proposition 71 is unconstitutional and, in general, to prevent CIRM from fulfilling the purposes for which it was created. The two remaining actions were consolidated into one action in October 2005. Trial of the consolidated action commenced on February 27, 2006 and concluded March 3, 2006. On April 21, 2006, the Superior Court issued a proposed Statement of Decision upholding the constitutionality of Proposition 71 in its entirety and rejecting each of the plaintiffs' claims. Plaintiffs have ten days to file objections to the decision, and after the court enters judgment, plaintiffs will have 30 days to file a notice of appeal. Due to the uncertain nature of these legal actions, management was unable to estimate any potential range of loss or impact on CIRM's proposed operations.

ADDITIONAL INFORMATION

CALIFORNIA INSTITUTE OF REGENERATIVE MEDICINE

COMBINING SCHEDULE OF NET ASSETS

JUNE 30, 2005

	<u>Non-Grant</u>			
	<u>Funds</u>	<u>Dolby Grant</u>	<u>Eliminations</u>	<u>Total</u>
ASSETS				
Cash and equivalents	\$ 112,154	\$ 5,000,000		\$ 5,112,154
Due from other fund	<u>139,224</u>		\$ <u>(139,224)</u>	<u>0</u>
Total assets	<u>\$ 251,378</u>	<u>\$ 5,000,000</u>	<u>\$ (139,224)</u>	<u>\$ 5,112,154</u>
LIABILITIES				
Accounts payable	\$ 251,668	\$ 752,873		\$ 1,004,541
Due to other funds	<u>1,650,000</u>	<u>139,224</u>	\$ <u>(139,224)</u>	<u>1,650,000</u>
Total liabilities	<u>1,901,668</u>	<u>892,097</u>	<u>(139,224)</u>	<u>2,654,541</u>
NET ASSETS				
Restricted	<u>\$ (1,650,290)</u>	<u>\$ 4,107,903</u>	<u>\$ -</u>	<u>\$ 2,457,613</u>

CALIFORNIA INSTITUTE OF REGENERATIVE MEDICINE

COMBINING SCHEDULE OF ACTIVITIES

FOR THE PERIOD FROM INCEPTION (NOVEMBER 2, 2004) TO JUNE 30, 2005

	<u>Non-Grant Funds</u>	<u>Dolby Grant</u>	<u>Total</u>
REVENUES			
Grant Revenue (Note 6)		\$ 5,000,000	\$ 5,000,000
Other (Note 5)	\$ 84,660		84,660
Total revenues	<u>84,660</u>	<u>5,000,000</u>	<u>5,084,660</u>
EXPENSES			
Salaries and benefits	591,627	145,078	736,705
Operating expenses	<u>1,143,323</u>	<u>747,019</u>	<u>1,890,342</u>
Total expenses	<u>1,734,950</u>	<u>892,097</u>	<u>2,627,047</u>
Change in net assets	(1,650,290)	4,107,903	2,457,613
Net assets, at inception	<u>-</u>	<u>-</u>	<u>-</u>
Net assets, at June 30, 2005	<u>\$ (1,650,290)</u>	<u>\$ 4,107,903</u>	<u>\$ 2,457,613</u>



Gilbert Associates, Inc.
CPAs and Advisors

Zach Hall, President
California Institute of Regenerative Medicine

In planning and performing our audit of the financial statements of the California Institute of Regenerative Medicine (CIRM) for the period ended June 30, 2005, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control.

However, during our audit we became aware of certain matters that are opportunities for improving operating efficiency and internal controls. This letter summarizes our comments and recommendations regarding those matters. This letter does not affect our report dated March 10, 2006 on the financial statements of CIRM.

FINANCIAL STATEMENT CLOSING PROCESS

For the year ended June 30, 2005, the accounting records of CIRM were properly closed in accordance with State accounting procedures. In the future, we recommend that in addition to closing the books in accordance with standard State accounting procedures, separate financial statements for CIRM should also be prepared in accordance with GASB 34. This includes converting fund-basis financial statements to government-wide financial statements, preparation of footnotes, and the preparation of a management's discussion and analysis section. This will benefit CIRM by increasing control over the content and completion of the financial statements and reducing the completion time of the audited financial statements. To accomplish this, we recommend that CIRM consider enlisting the assistance of the State Controller's Office Division of Accounting and Reporting.

CONFLICT OF INTEREST FORMS

In accordance with Chapter 3, Article 1, Section 125290.30(g) of Proposition 71 and Government Code Section 87300, the Independent Citizens' Oversight Committee (ICOC) adopted a proposed Conflict of Interest Code for its members and for employees of CIRM. In addition, the ICOC also adopted conflict of interest policy statements for its members and employees of CIRM.

It is our understanding that most of the ICOC members attended the meeting at which the ICOC policy statement was considered and they voted unanimously to approve it. In addition, copies of the conflict of interest statement for ICOC members have been given to all members not in attendance at that meeting and to new ICOC members, including authorized alternates, at the time of appointment. However, during the audit period we noted that there was no place for the ICOC members to sign the statement indicating their agreement to abide by requirements of the conflict of interest statement. We recommend that CIRM management ensure that all ICOC members and designated alternates sign the approved conflict of interest statement.

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Zach Hall
California Institute for Regenerative Medicine
March 10, 2006
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We will review the status of these issues and recommendations during our next audit engagement. We have already discussed them with CIRM's management, who have agreed to implement all recommendations. We will be pleased to discuss them in further detail at your convenience, to perform any additional study of this matter, or to assist you in implementing the recommendations. This report is intended solely for the information and use of the CIRM and its staff and the members of the ICOC and is not intended to be and should not be used by anyone other than these specified parties.

Gilbert Associates, Inc.
GILBERT ASSOCIATES, INC.
March 10, 2006